

This letter discusses the sales tax treatment of cellular phones when they are either given away or sold. (This is a GIL).

April 12, 2002

Dear Xxxxx:

This letter is in response to your letter dated January 16, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

We would appreciate guidance as to the appropriate sales and/or use tax treatment of transactions involving the sale of cellular phones together with cellular service to retail customers.

#### STATEMENT OF FACTS

AAA is an authorized agent of BBB. As an authorized agent, AAA sells cellular phones to retail customers together with cellular phone service from BBB. When purchasing a phone, a customer is required to enter into either a one year or two year service agreement with BBB. In addition to amounts received from the retail customer, AAA receives activation commissions and equipment rebates from BBB upon the activation of each customer's phone as well as monthly account maintenance fees based upon the monthly revenues received by BBB from the customer.

At present, BBB pays us a \$ equipment rebate for each activation of a customer who enters into a one year service agreement and an \$ equipment rebate for each activation of a customer who enters into a two year service agreement. In addition, BBB pays us activation commissions ranging from \$ to \$ for each activation depending upon the type of service plan the customer chooses and whether the customer is new or existing. Portions of the equipment rebate and activation commission paid by BBB are used to subsidize the sales price of a phone to the customer. Consequently, the customer will typically purchase a phone at a price that is substantially less than our cost for the phone. In fact, we often give away phones for free. In addition, our phone pricing is often tied to national or regional promotions funded by BBB.

At present, we collect sales and use taxes based upon the cost of the phone if that cost exceeds the sales price. For example, if a phone costs \$ and we give it away, we collect

a sales tax based upon the phone cost of \$. If a phone costs \$ and we sell it for \$, we collect a sales tax based upon the phone cost of \$. Our present treatment of such sales is based upon oral suggestions received from Illinois Department of Revenue personnel and our interpretation of ST 97-0275-GIL. However, we are not aware of any ruling directly addressing the issues presented below.

## RULING REQUESTS

### Scenario 1:

AAA receives an equipment rebate of \$ and an activation commission of \$ from BBB for activating a phone for a customer who enters into a two year service agreement. The customer receives the phone for free. The cost of the cellular phone to AAA is \$. There is no national or regional promotional price for the phone.

Should AAA remit tax based upon the cost of the phone of \$ or the equipment rebate of \$? If neither, what is the correct taxable base for sales\use tax collection and remittance?

### Scenario 2:

AAA receives an equipment rebate of \$ and an activation commission of \$ from BBB for activating a phone for a customer who enters into a two year service agreement. The customer receives the phone for free pursuant to a regional promotion underwritten by BBB. The cost of the cellular phone to AAA is \$.

Should AAA remit tax based upon the cost of the phone of \$ or the equipment rebate of \$? If neither, what is the correct taxable base for sales\use tax collection and remittance?

### Scenario 3:

AAA receives an equipment rebate of \$ and an activation commission of \$ from BBB for activating a phone for a customer who enters into a two year service agreement. The customer purchases the phone for \$. The cost of the cellular phone to AAA is \$. There is no national or regional promotional price for the phone.

Should AAA remit tax based upon the cost of the phone of \$, the \$ received from the customer or \$, the sum of the equipment rebate and the sales price? If none of the above, what is the correct taxable base for sales/use tax collection and remittance?

### Scenario 4:

AAA receives an equipment rebate of \$ and an activation commission of \$ from BBB for activating a phone for a customer who enters into a two year service agreement. The customer purchases the phone for \$. The cost of the cellular phone to AAA is \$. There is no national or regional promotional price for the phone.

Should AAA remit tax based upon the cost of the phone of \$, the \$ received from the customer or \$, the sum of the equipment rebate and the sales price? If none

of the above, what is the correct taxable base for sales/use tax collection and remittance?

Scenario 5:

AAA receives an equipment rebate of \$ and an activation commission of \$ from BBB for activating a phone for a customer who enters into a two year service agreement. The customer purchases the phone for \$ pursuant to a national promotion underwritten by BBB. The cost of the cellular phone to AAA is \$.

Should AAA remit tax based upon the cost of the phone of \$, or \$ received from the customer or \$, the sum of the equipment rebate and the sales price? If none of the above, what is the correct taxable base for sales\use tax collection and remittance?

REQUEST FOR DELETIONS OF MATERIAL

AAA and BBB deem the amounts paid as compensation by BBB to be trade secrets. Consequently, we request that all dollar amount references set forth in the Statement of Facts be redacted from the publicly disseminated version of the private letter ruling. In addition, all references to either AAA, BBB, or the undersigned or related contact information also should be redacted.

Thank you for your kind consideration of these matters. Please feel free to contact me. Please forward your response to the undersigned at the above address.

You referred to the Department's General Information Letter number ST 97-0275-GIL in your letter. We would like to review some of the information in that letter, here.

If retailers sell cellular phones to their customers, the retailers incur Retailers' Occupation Tax measured by the gross receipts from the sales. At the time the retailers purchase cellular phones from their suppliers, the retailers should supply Certificates of Resale to their suppliers. Then, when the retailers sell the cellular phones, the retailers will pay Retailers' Occupation Tax based on the amount they receive from all sources. This amount represents the gross receipts received from the sale of the phone. If a retailer purchases a phone for \$ and sells it for \$, the tax due would be based on the amount of gross receipts from the sale; that is, \$.

It is important that retailers be very careful when computing the amount of gross receipts from the sales of their cellular phones. "Gross receipts" means "all the consideration actually received by the seller, except traded-in tangible personal property" from all sources. See 86 Ill. Adm. Code 130.401. If the money retailers receive from cellular service providers is the equivalent of a reimbursement for a discount offered to the purchaser, then this amount is included in gross receipts and is taxable. For example, if a retailer purchases a phone for \$ and then sells the phone to a customer for \$ and also receives \$ from the cellular service provider, the gross receipts from the sale of the phone are \$. Tax would be based on \$. The retailers are required to collect a complementary Use Tax liability from their customers when the sales of the phones occur. The tax should be listed as a separate item from the selling price of the equipment and not as an administration or service charge.

If the money retailers receive from cellular service providers represents compensation based on a percentage of an amount agreed to be paid for every activation, it is not subject to sales tax. However, it is subject to income tax.

In the scenarios that you have described, your letter indicates that a portion of the "equipment rebate" is a payment that you receive for the sale of the phones. Your letter also indicates that a portion of the "activation commission" is a payment that you receive for the sale of the phones. We cannot tell whether you receive additional gross receipts as a result of the regional promotions.

In Scenario 1, you receive \$ as an equipment rebate and \$ as an activation commission from BBB for activating a phone for a customer who enters into a service agreement. The customer receives the phone for free. Based upon the limited information provided, it appears that you are selling the phone to BBB. BBB apparently directs you to give the phone to the customer. Whatever portion of the equipment rebate and the activation commission are payment to you for the phone are your gross receipts for the sale of the phone. You should give a resale certificate to your supplier when you purchase the phone. When you sell the phone, you owe Retailers' Occupation Tax and applicable local tax on your gross receipts, and BBB owes the corresponding Use Tax and applicable local tax reimbursements. It is important that you keep records of the amount of gross receipts you receive for sale of the phone. If you do not, an auditor will use his best information and judgment to determine the amount of gross receipts.

The situation in Scenario 2 is similar to the one in Scenario 1. You receive an \$ equipment rebate and a \$ activation commission from BBB. The customer receives the phone for free. Tax should be based on the portion of the \$ and \$ that is payment for the phone. As indicated above, we do not know what additional effect the regional promotion may have on your tax liabilities.

In regard to Scenario 3, you sell the phone to the customer for \$. However, you also receive an equipment rebate of \$ and an activation commission of \$. You should give a resale certificate when you purchase the phone. Then when you sell the phone, tax for the sale of this phone should be based on the \$ from the customer and whatever portion of the \$ equipment rebate and \$ activation commission were payment for the phone.

In Scenario 4, you receive an equipment rebate of \$ and an activation commission of \$. You also receive \$ from the customer for the phone. Tax should be based on whatever portion of the \$ and \$ was payment for the phone plus the \$ received from the customer.

In Scenario 5, you receive an equipment rebate of \$ and an activation commission of \$ and \$ from the customer pursuant to a national promotion. Tax should be based on whatever portion of the \$ and \$ was reimbursement for the phone plus \$. As indicated above, we do not know what additional effect the national promotion may have on your tax liability.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk